

E-002/M-93-1328 ORDER APPROVING DEFERRED ACCOUNTING

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Don Storm  
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Chair  
Commissioner  
Commissioner  
Commissioner  
Commissioner

In the Matter of the Request of Northern States  
Power Company for Approval of Deferred  
Accounting Treatment of Interest Paid on  
Income Tax and Sales Tax Changes

ISSUE DATE: May 19, 1994

DOCKET NO. E-002/M-93-1328

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**PROCEDURAL HISTORY**

On December 30, 1993, Northern States Power Company (NSP or the Company) filed a petition seeking approval of deferred accounting for certain interest payments made and received in 1993. The interest items arose from changes in NSP's tax liability following an IRS field audit of the Company's 1987 and 1988 returns and the resolution of a dispute regarding Minnesota sales tax.

On February 7, 1994, the Department of Public Service (the Department) filed comments in support of the Company's request for deferred accounting.

The matter came before the Commission on May 5, 1994.

**FINDINGS AND CONCLUSIONS**

**I. The Company Proposal**

NSP requested approval of deferred accounting for three items: net interest expense (income) on changes made to the Company's 1987 and 1988 federal income tax returns as a result of the completion of an IRS audit; net interest expense (income) on changes made to NSP's 1985 through 1988 Minnesota income tax returns as a result of changes made on the federal tax level; interest on changes made to NSP's Minnesota sales and use tax returns for the months of July, 1985, through June, 1987, as a result of the completion of a state audit.

NSP also included information on additional investment tax credits allowed by the IRS upon completion of its 1987 and 1988 income tax audits. NSP stated that it would flow back

additional tax credits as a result of these tax credits. No Commission permission or action was necessary at this time.

## **II. Treatment of Deferral in the Company's Last Electric Rate Case**

In NSP's most recent electric rate case<sup>1</sup> (the 1993 rate case) the Company sought to include in the test year four items arising from the resolution of pre-test year tax disputes. The items included tax credits for three successful IRS dispute resolutions and interest on amounts paid to the IRS following its audit of the Company's 1984, 1985, and 1986 returns. The Company also sought to establish a tax tracker system to defer debits and credits at the time tax disputes are resolved.

In the 1993 rate case Final Order the Commission allowed the Company to include the pre-test year tax credits and interest expenses in the test year. The amount included was to be amortized over two years, with the unamortized balance included in rate base.

The Commission did not allow the Company to set up an automatic tracker system for tax items. Rather, the Company was required to seek permission for deferred accounting as future tax issues are resolved.

To maintain an element of control over the items deferred, the Commission will require that the Company petition for deferred accounting status of both tax credits and debits at the time the final decisions are received on the disputed items. Items for which deferred status is sought should be limited to significant and unusual disputed items related to utility operations, for which ratepayers have incurred costs or received benefits.

FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER at p. 58 (September 29, 1993).

## **III. Commission Analysis**

The Commission agrees with the Department that deferred accounting for interest on tax adjustments should be allowed in this case.

### **A. Similarity to Previous Items**

The items proposed for deferral are factually similar to those allowed in the 1993 general rate case. The Company's first item in its proposal, interest on changes resulting from the IRS audit of 1987 and 1988 returns, is nearly parallel to an item allowed in 1993, interest on further taxes due following the IRS audit of 1984-1986 returns. The Company's second item in the proposal, interest on changes in state taxes due, stems from the federal tax changes. The Company's third requested item is interest on additional taxes paid after resolution of a long-standing dispute with the Minnesota Department of Revenue regarding sales and use taxes. This item is analogous to three items allowed in the 1993 rate case, each involving tax credits from resolution of long-standing disputes with the IRS. Although these 1993 items were credits and the present proposal is for interest on taxes paid, the principle is the same.

### **B. Procedure Used**

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<sup>1</sup> In the Matter of the Application of Northern States Power Company for Authority to Increase Its Rates for Electric Service in the State of Minnesota, Docket No. E-002/GR-92-1185.

The Company not only submitted proposed items which were factually similar to those included in 1993, but also followed the procedure established by the Commission in the 1993 rate case Final Order. As required by the Commission, the Company petitioned for deferred accounting of the three tax items when their disposition became clear following dispute resolution.

### **C. Parameters for Deferred Status**

The tax items in NSP's proposal followed the parameters for deferred status used by the Commission in the 1993 rate case. The items for which deferral is sought are "significant and unusual" under the analysis followed in the 1993 Final Order. Like the 1993 items, these interest payments followed complex disputes with the taxing authorities. By their nature, these items were not amenable to inclusion in a test year because of the lengthy dispute resolution processes involved. The items for which deferral is sought amounted to over \$1.5 million, clearly a significant sum.

In the 1993 rate case Final Order the Commission also stated that deferred status would only be bestowed upon items "related to utility operations." The current proposed tax items stem from payments of federal income taxes and state and use taxes. These items are related to utility operations.

Ratepayer benefit is another parameter for deferred status discussed by the Commission in the 1993 rate case Final Order. In its current proposal the Company supplied information to show that ratepayer benefits from accumulated deferred taxes have exceeded interest costs for the years 1985 to 1993. This information is sufficient to bring the proposed items within the ratepayer benefit parameter for deferred status. The final analysis of the prudence and reasonableness of the costs associated with the tax items will be fully examined in the Company's next general rate case, when deferral will culminate.

The Company has proposed deferral of tax items which are factually similar to those included in the 1993 rate case. The items fit the parameters discussed in the 1993 rate case Final Order. The Company followed the deferral procedure which the Commission established in

the prior proceeding. For these reasons, the Commission will allow the Company to defer the proposed tax items pending ratemaking determination in a rate case or other formal proceeding.

#### **D. Policy Discussion**

As the Commission reasoned in the 1993 rate case, NSP should not lose its incentive to aggressively pursue favorable tax decisions. The Commission discussed this reasoning at p. 57 of the 1993 rate case Final Order:

Typically, a utility will estimate costs for a test year, parties have a process available to review those estimates, and rates are ultimately set. If the circumstances change, causing expenses to deviate significantly from the estimates used for rate setting, either the utility could seek a rate change or a rate change proceeding could be initiated by the Commission. However, with the tax disputes, significant changes in estimates may only be realized a number of years later, too late to initiate a rate change to correct for the change in circumstances in a timely manner. This leads to a higher degree of risk faced by the utility, especially if the utility takes an aggressive posture in interpreting tax laws, a posture which may lead to decreased costs for ratepayers. Thus it is appropriate for the Company to seek deferred accounting treatment for disputed tax items.

As in the 1993 rate case, allowing deferred accounting in this case will allow the proper incentive for the Company's aggressive tax positions. The Commission notes that a decision to allow deferral does not equal a decision on the merits of the items deferred. The prudence and reasonableness of these items will be decided along with other items of revenue and expense in a general rate case, or in a special proceeding focused on the ratemaking consequences of the tax items.

The Commission notes further that its decision does not mean that every item of expense or income associated with tax adjustments will be automatically allowed deferred accounting. As the Commission stated in the 1993 rate case, NSP and other utilities must present each item at the time of its disposition and seek permission for deferral on a case by case basis.

#### **IV. Application to the Gas Utility as Well as the Electric Utility**

The issue of debits and credits following tax adjustments arose in NSP's 1993 electric general rate case. Although the Company had a concurrent gas utility general rate case (Docket No. E-002/GR-92-1186) the issue did not arise in that proceeding.

The Company now seeks approval of deferred accounting for tax items which affect both the electric and the gas utilities. The Commission will extend the reasoning of its 1993 decision to both NSP utilities, and allow deferred accounting for the Company's entire proposal. Since

the utilities share common ownership and are closely interrelated, it is reasonable to treat this accounting question consistently for both utilities.

**ORDER**

1. The Commission approves NSP's December 30, 1993 request for approval of deferred accounting.
2. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar  
Executive Secretary

(S E A L)